**DEPARTMENT OF STATE REVENUE**

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**Letters of Findings Numbers: 08-0609 & 08-0610**
**Withholding Tax and Sales Tax**
**For Tax Years 2002-06**

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## ISSUES

**I. Withholding Tax–Independent Contractors.**

**Authority:** Snell v. C.J. Jenkins Enterprises, Inc., 881 N.E.2d 1088 (Ind. Ct. App. 2008); IC § 6-3-4-8; IC § 6-8.1-5-1; 45 IAC 3.1-1-97; Internal Revenue Service Publication 15 (2008).

Taxpayer protests the assessment of withholding tax on payments to mechanics at its body shop.

**II. Sales Tax–Body Shop Repairs.**

**Authority:** IC § 6-2.5-4-1; IC § 6-8.1-5-1; 45 IAC 2.2-4-2.

Taxpayer protests the imposition of sales tax on parts used for body shop repairs.

**III. Tax Administration–Negligence Penalty.**

**Authority:** IC § 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests the imposition of a ten percent negligence penalty.

## STATEMENT OF FACTS

Taxpayer is an Indiana automobile body shop. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer should have withheld tax on amounts it paid the mechanics who worked at the body shop and that Taxpayer should have collected sales tax on the repairs it made. The Department therefore issued proposed assessments for withholding tax, sales tax, penalty, and interest. Taxpayer protests the imposition of these proposed assessments. An administrative hearing was held and these Letters of Findings result. The Department assigned a docket number for the protest concerning withholding tax and a separate docket number for the protest concerning sales tax. For convenience, both protests will be addressed in this combined Letter of Findings. Further facts will be supplied as necessary.

**I. Withholding Tax–Independent Contractors.**

## DISCUSSION

Taxpayer protests the imposition of withholding tax. Taxpayer states that the mechanics who worked at the body shop were in fact independent contractors who were not employees and did not receive salaries. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The withholding tax is imposed under IC § 6-3-4-8(a), which (as in effect during the audit period) stated:

> Except as provided in subsection (d) or (l), every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department. The department shall base its withholding instructions on the adjusted gross income tax rate for persons, on the total rates of any income taxes that the taxpayer is subject to under IC 6-3.5, and on the total amount of exclusions the taxpayer is entitled to under IC 6-3-1-3.5(a)(3) and IC 6-3-1-3.5(a)(4). Such employer making payments of any wages:
>
> (1) shall be liable to the state of Indiana for the payment of the tax required to be deducted and withheld under this section and shall not be liable to any individual for the amount deducted from the individual's wages and paid over in compliance or intended compliance with this section; and
>
> (2) shall make return of and payment to the department monthly of the amount of tax which under this article and IC 6-3.5 the employer is required to withhold.

Also, the Department refers to 45 IAC 3.1-1-97, which states in relevant part:

> Employers who make payments of wages subject to the Adjusted Gross Income Tax Act, and who are required to withhold Federal taxes pursuant to the Internal Revenue Code (USC Title 26), are required to withhold from employees' wages Adjusted Gross and County Adjusted Gross Income Tax.
>
> ....

During the audit, Taxpayer told the Department that it considered the mechanics to be independent contractors and not employees. Taxpayer stated that the mechanics received federal form 1099s rather than W-2s. When asked to provide copies of the forms, Taxpayer did not have any copies and did not have the federal Employer Identification Number (EIN) under which the 1099s were issued.

In the audit report, the Department referred to Internal Revenue Service (IRS) Publication 15 (2008) (Circular

E) which states in relevant part:

...

Generally, employees are defined either under common law or under statutes for certain situations. Employee status under common law. Generally, a worker who performs services for you is your employee if you have the right to control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed.

....

The Department believed that Taxpayer's relationship with the mechanics constituted an employer-employee relationship, as provided above by IRS Publication 15. Taxpayer was therefore required to withhold tax on the payments it made to the mechanics, as provided by IC § 6-3-4-8(a) and 45 IAC 3.1-1-97.

At hearing, Taxpayer again protested that the mechanics were independent contractors and not employees. Taxpayer provided additional explanation of the working arrangements at the body shop. Taxpayer explained that the mechanics provided their own tools, worked on an irregular as-needed basis, and did their own work on the vehicles in the shop.

The Court of Appeals of Indiana addressed the problem of determining if a person is an employee or an independent contractor in the case Snell v. C.J. Jenkins Enterprises, Inc., 881 N.E.2d 1088 (Ind. Ct. App. 2008). In that case, the plaintiff (Snell) wanted to be considered an employee in order to recover some money, which he believed was owed by the defendant (Enterprises), using Indiana wage statutes. The court determined that the plaintiff was an independent contractor. The court explained:

Because the question at issue here is whether Snell was Jenkins's employee or an independent contractor, we too will employ the ten-factor test pursuant to the Supreme Court's direction in Moberly. These ten factors are as follows:

(a) the extent of control which, by the agreement, the master may exercise over the details of the work;
(b) whether or not the one employed is engaged in a distinct occupation or business;
(c) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision;
(d) the skill required in the particular occupation;
(e) whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work;
(f) the length of time for which the person is employed;
(g) the method of payment, whether by the time or by the job;
(h) whether or not the work is a part of the regular business of the employer;
(i) whether or not the parties believe they are creating the relation of master and servant; and
(j) whether the principal is or is not in business.
(Id., at 1091).

The court discussed each factor and determined whether that particular factor weighed towards Snell's status as an employee or an independent contractor. The court also considered how strongly each factor weighed in which direction. Ultimately, the court determined that enough factors weighed strongly enough to rule that Snell was an independent contractor.

Applying those ten factors to the instant case, the mechanics at Taxpayer's body shop were independent contractors. The mechanics were only responsible for performing the repairs without direct supervision by Taxpayer. The mechanics were able to perform repairs for others when not working at Taxpayer's body shop. The skills required to perform the work are specific to that trade. The mechanics supplied their own tools. There was no specific time frame for the mechanics to work at Taxpayer's body shop. The mechanics were paid by the job, not by salary or hourly wage, and Taxpayer was not responsible for providing benefits. As explained by the court in Snell, the beliefs of the parties are not determinative, but they do indicate one party's assumption of control over the other party. Here, the parties considered themselves to be in an independent contractor relationship. Therefore, seven of the ten factors indicate an independent contractor relationship.

The remaining three factors weigh in favor of the employer/employee relationship. However, as explained by the court in Snell, these factors do not weigh heavily in the computation. Overall, seven factors indicate an independent contractor relationship, while three indicate an employer/employee relationship. Also, the factors which indicate an independent contractor relationship weigh more heavily than the factors which indicate an employer/employee relationship.

Therefore, Taxpayer was not responsible for collecting withholding taxes. The mechanics were independent contractors, as determined by using the procedure described in Snell. However, Taxpayer is hereby notified that the Department will not go through this detailed evaluation again. Taxpayer only needs to keep copies of the 1099s it issued to the mechanics to establish that they are independent contractors. The burden of making and keeping copies is much smaller for Taxpayer than the burden of conducting an audit and a protest is for the Department. If, in future years, Taxpayer does not make and keep copies of the 1099s available for the Department's review, the mechanics will be considered employees and Taxpayer will be responsible for

withholding on those employees.

**FINDING**

Taxpayer's protest is sustained.

**II. Sales Tax–Body Shop Repairs.**

**DISCUSSION**

Taxpayer protests the imposition of sales tax on sales it made during the audit period. Taxpayer states that most of its sales were to exempt car dealerships and that sales tax was therefore not due. Taxpayer also states that it often used parts supplied by the owners of the vehicles being repaired. Taxpayer provided many receipts which show that sales tax was paid at the time Taxpayer purchased the parts which were then used in the repairs. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The Department refers to IC § 6-2.5-4-1, which states in relevant part:

(a) A person is a retail merchant making a retail transaction when he engages in selling at retail.

(b) A person is engaged in selling at retail when, in the ordinary course of his regularly conducted trade or business, he:

(1) acquires tangible personal property for the purpose of resale; and

(2) transfers that property to another person for consideration.

(c) For purposes of determining what constitutes selling at retail, it does not matter whether:

(1) the property is transferred in the same form as when it was acquired;

(2) the property is transferred alone or in conjunction with other property or services; or

(3) the property is transferred conditionally or otherwise.

....

Also, 45 IAC 2.2-4-2, states:

(a) Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where, in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10[percent]) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

(b) Services performed or work done in respect to property and performed prior to delivery to be sold by a retail merchant must however, be included in taxable gross receipts of the retail merchant.

(c) Persons engaging in repair services are servicemen with respect to the services which they render and retail merchants at retail with respect to repair or replacement parts sold.

(d) A serviceman occupationally engaged in rendering professional, personal or other services will be presumed to be a retail merchant selling at retail with respect to any tangible personal property sold by him, whether or not the tangible personal property is sold in the course of rendering such services. If, however, the transaction satisfies the four (4) requirements set forth in 6-2.5-4-1(c)(010), paragraph (1) [subsection (a) of this section], the gross retail tax shall not apply to such transaction.

(Emphasis added).

Also, IC § 6-8.1-5-1(b) states:

If the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to IC 6-8.1-10 concerning the imposition of penalties and interest. The department shall send the person a notice of the proposed assessment through the United States mail.

(Emphasis added).

The Department used the best information available to it to arrive at the numbers it used for the proposed sales tax assessments. It used the average taxable sales percentages of four unrelated and independently owned body shops in Taxpayer's area to arrive at an average taxable sales percentage. That percentage was then applied to Taxpayer's sales for the audit years.

Taxpayer protests that the four unrelated body shops had much higher sales than it did. Also, Taxpayer protests that the other shops did much more business with franchise car dealers than Taxpayer did. Taxpayer states that those franchises provide much more insurance work than it did, which resulted in much higher percentages of taxable sales. While the Department understands Taxpayer's protest, there is no documentation available to establish that this position is correct. Also, there is no documentation to establish what Taxpayer's

actual taxable percentage was. It is reasonable for the Department to refer to similarly situated taxpayers to determine Taxpayer's taxes due in the absence of complete records.

Taxpayer explained that it had been required to move from its original body shop location to another location shortly before the audit and that many of its records were in storage. The Department allowed Taxpayer time during the audit and during the protest process to provide records to establish which sales were subject to sales tax and which were not. Taxpayer did provide some receipts which do show that sales tax was paid on the parts at the time Taxpayer purchased them.

These receipts are not enough to show which of Taxpayer's customers were exempt and which were not. While the receipts do show sales tax paid, they do not establish which vehicles these parts went into, let alone if those vehicles were exempt or taxable. Also, the Department did not impose sales tax on one hundred percent of Taxpayer's sales. The receipts do not establish whether or not the parts in question were included in the percentage which the Department has already agreed was not taxable.

In conclusion, Taxpayer did not keep adequate records available for the Department to review and determine the taxable percentage of sales. The Department therefore used the best information available to reach its proposed assessments, as provided by IC § 6-8.1-5-1(b). Taxpayer was a retail merchant making retail sales as defined by IC § 6-2.5-4-1. While Taxpayer may disagree with the Department's position, the burden is on Taxpayer to prove the proposed assessments wrong, as provided by IC § 6-8.1-5-1(c). Taxpayer has not met this burden.

**FINDING**

Taxpayer's protest is denied.

**III. Tax Administration–Negligence Penalty.**

**DISCUSSION**

The Department issued proposed assessments and the ten percent negligence penalty and interest for the tax years in question. Taxpayer protests the imposition of penalty.

The Department refers to IC § 6-8.1-10-2.1(a), which states in relevant part:

If a person:

. . .

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

. . .

the person is subject to a penalty.

The Department refers to 45 IAC 15-11-2(b), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

45 IAC 15-11-2(c) provides in pertinent part:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, Taxpayer incurred a deficiency which the Department determined was due to negligence under 45 IAC 15-11-2(b), and so was subject to a penalty under IC 6-8.1-10-2.1(a). Taxpayer has not affirmatively established that its failure to pay the deficiency was due to reasonable cause and not due to negligence, as required by 45 IAC 15-11-2(c). The negligence penalty shall not be waived. However, since Taxpayer was sustained on Issue I, only the base amount of sales tax due discussed in Issue II will be subject to penalty.

**FINDING**

Taxpayer's protest is denied.

**CONCLUSION**

Taxpayer is sustained on Issue I regarding imposition of withholding tax. Taxpayer is denied on Issue II regarding imposition of sales tax. Taxpayer is denied on Issue III regarding imposition of negligence penalty.

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